No. 04-1264

Supreme Court, U.S.
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In The
Supreme Court of the United States

BUCKEYE CHECK CASHING, INC.,

Petitioner,

v.

JOHN A. CARDEGNA AND DONNA REUTER,

Respondents.

On Writ Of Certiorari To The Supreme Court Of Florida

BRIEF OF AMICUS CURIAE SAMUEL GLAZER IN SUPPORT OF RESPONDENTS

KENNETH D. SCHWARTZ, *Counsel of Record*
ROBERT P. DUVIN
EMILY C. FIFTAL

DUVIN, CAHN & HUTTON
Erieview Tower, 20th Floor
1301 East Ninth Street
Cleveland, Ohio 44114
Telephone: (216) 696-7600
Facsimile: (216) 696-2038
kschwartz@duvin.com
rduvin@duvin.com
efiftal@duvin.com

Counsel for Amicus Curiae

COCKLE LAW BRIEF PRINTING CO. (800) 225-6964
OR CALL COLLECT (402) 342-2831

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INTEREST OF AMICUS CURIAE[1]

Amicus Curiae Samuel Glazer is the Petitioner in *Samuel Glazer v. Lehman Brothers, Inc., et al.*, No. 04-1375. Glazer's Petition for a Writ of Certiorari is currently pending and is scheduled for conference on September 26, 2005.

Glazer's lawsuit against Lehman Brothers, Inc., and SG Cowen Securities Corp. stems from probably the largest fraud ever committed by a single securities broker in this country, involving numerous investors and hundreds of millions of dollars. Samuel Glazer lost millions because these brokerage firms wilfully and unlawfully turned a blind eye to a shockingly open and obvious criminal in their employ. The breadth of the firms' malfeasance – in terms of length of time and the knowing continuance of violations of securities laws and regulations even in the face of explicit warnings – is described in Administrative Orders issued by the Securities and Exchange Commission and in non-prosecution agreements reached with Ohio county prosecutors.[2]

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[1] This brief is filed pursuant to each parties' general consent to the filing of all amicus briefs, filed by each party on August 1, 2005. This brief has not been authored, in whole or in part, by counsel for any party in this case. No person or entity other than Amicus Curiae, Samuel Glazer, or his counsel made a monetary contribution to the preparation or submission of this brief.

[2] *See* Lehman Bros., Inc., Exchange Act Release No. 48336, 80 SEC Docket 2512-39 (Aug. 14, 2003) ($2.5 million fine), *available at* http://www.sec.gov/litigation/admin/34-48335.htm; SG Cowen Secs. Corp., Exchange Act Release No. 48335, 80 SEC Docket 2501-38 (Aug. 14, 2003) ($5 million fine), *available at* http://www.sec.gov/litigation/admin/34-48336.htm.; *see* John Caniglia & Sandy Theis, *How County Got $9 Million*, Plain Dealer (Cleveland), Jan. 8, 2004, at A1.

In mid-1998, Glazer met Frank Gruttadauria, who was a broker, Managing Director, and Office Manager for SG Cowen Securities Corp. Glazer did not know it, but Gruttadauria was actually a full-time criminal. For over twelve years, Gruttadauria had been using the brokerage's systems and policies to steal money and stock from customer accounts, to divert real account statements to post office boxes to hide his fraud, and to create fake account statements for customers in order to hide his actions and to create the appearance of outstanding investment success.

Gruttadauria, who is now in prison, has admitted that he was desperate when he met Glazer. After stealing from customers for over 12 years, he needed "new money" to satisfy customers' recent withdrawal demands. Gruttadauria targeted Glazer, who is now in his eighties. Glazer told Gruttadauria he would not sign an account agreement containing an arbitration provision. Glazer had refused to sign such agreements in the past, including with SG Cowen's predecessor (Cowen & Co.). Gruttadauria told Glazer that his "title as managing Director of SG Cowen was sufficient to assure him that SG Cowen would not enforce arbitration against him." With this assurance, Glazer signed and transferred stock and cash which was immediately stolen by Gruttadauria. No legitimate transaction was ever made for Glazer, and he never received any legitimate account statement showing the reality of his assets being stolen. The brokerage firms do not dispute these facts.

Gruttadauria's criminal scheme finally collapsed in January of 2002, but not due to the brokerage firms. He disappeared and left a note for the FBI: "I can hardly believe that I could have done this without detection for so

long, the various firms greed and lack of attention at a senior level contributed greatly to that." It is now estimated that Gruttadauria stole between $115-$150 million in capital and created an additional $275-$300 million of fictional net worth in fake account statements printed from his office desktop computer.

Glazer sued Lehman and SG Cowen in federal court asserting several claims including statutory securities fraud, common law fraud, breach of fiduciary duty, and estoppel. The brokerage firms filed motions to compel arbitration based on the same account documents that were an integral part of Gruttadauria's crime. Glazer opposed the motions on the ground that the entire account agreement never came into existence, *i.e.*, was void from its inception, because Gruttadauria's criminal purpose barred the formation of any contract based on ordinary principles of state contract formation law. Glazer also asserted that Gruttadauria's lie about the arbitration provision barred enforcement of that provision. The District Court held that under the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1 *et seq.*, it was authorized to determine whether the underlying account agreement came into existence. The District Court denied the motions to compel arbitration, ruling that because Gruttadauria never intended to act as a broker, but instead intended only to steal, there was never any meeting of the minds, never any underlying contract, and thus never any arbitration provision. *Fazio, et al. v. Lehman Bros., Inc., et al.*, 268 F. Supp. 2d 865 (N.D. Ohio 2002).

On appeal, the Sixth Circuit reversed and remanded. The Sixth Circuit completely refused to address Glazer's claim that no underlying contract ever came into existence. Relying on *Prima Paint v. Flood & Conklin Manufacturing*

Co., 388 U.S. 395 (1967), the court perfunctorily reversed and remanded with a mandate that the District Court only hear claims targeting the arbitration provision specifically, or claims of forgery or lack of signatory authority regarding the underlying agreement. *Fazio, et al. v. Lehman Bros. Inc., et al.*, 340 F.3d 386 (6th Cir. 2003).

On remand, *Prima Paint* "separability" was again an issue. Glazer re-asserted his challenge specifically concerning the arbitration provision, because Gruttadauria promised, and Glazer agreed, that arbitration would not be enforced. *Glazer v. Lehman Bros., Inc., et al.*, No. 1:02 CV 370 (N.D. Ohio Oct. 3, 2003). The District Court again refused to compel arbitration, but the Sixth Circuit again reversed. The court held that the oral agreement for no arbitration was barred by the parol evidence rule. But, in Ohio, an exception to parol evidence is the "sham agreement" doctrine, which provides that the parties can agree that the document they sign is not their real agreement (and therefore the contrary oral agreement is the real one and is enforced). The sham agreement doctrine only applies to whole contracts and not to discrete provisions. Glazer contended that the Sixth Circuit's view of separability required the court to view the arbitration provision as a whole, stand-alone contract, and thus apply the sham agreement doctrine to it. The Sixth Circuit disagreed, did not focus solely on the arbitration provision, and instead used the entire underlying contract as a basis for not applying the sham agreement doctrine.[3] *Glazer v. Lehman Bros., Inc., et al.*, 394 F.3d 444 (6th Cir. 2005)

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[3] Glazer's Petition for Writ of Certiorari seeks review of this second panel decision because it shows an improper, selective application of the "separability doctrine."

The first question presented by Glazer's Petition for a Writ of Certiorari is: "Must a court, and not an arbitrator, resolve *all* claims that the underlying contract is void from its inception?" This question directly encompasses the question accepted for review in the present case. Samuel Glazer's submission herein primarily supports the position of the Respondents.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Article III of the United States Constitution:

> The judges, both of the supreme and inferior courts, shall hold their offices during good behaviour, and shall, at stated times, receive for their services, a compensation, which shall not be diminished during their continuance in office. . . . The judicial power shall extend to all cases, in law and equity, arising under this Constitution, the laws of the United States . . . [and] to controversies . . . between citizens of different states. . . . U.S. Const. art. III, §§ 1, 2.

The Fifth Amendment to the U.S. Constitution:

> No person shall be . . . deprived of life, liberty, or property, without due process of law. . . . U.S. Const. amend. V.

The Seventh Amendment to the U.S. Constitution:

> In suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise reexamined in any

> court of the United States, than according to the rules of the common law. U.S. Const. amend. VII.

The Fourteenth Amendment to the U.S. Constitution:

> [N]or shall any state deprive any person of life, liberty, or property, without due process of law. . . . U.S. Const. amend XIV, § 1.

Section 2 of the Federal Arbitration Act, 9 U.S.C. § 2 (emphasis added):

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, *save upon such grounds as exist at law or in equity for the revocation of any contract.*

Section 3 of the FAA, 9 U.S.C. § 3:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

Section 4 of the FAA, 9 U.S.C. § 4 (emphasis added):

> A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. . . . *The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement.*

SUMMARY OF ARGUMENT

The fundamental question for resolution in this case is whether, under the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1 *et seq.*, a court or an arbitrator should resolve a claim that an underlying contract containing an arbitration provision never came into existence, or is void. The Petitioner, Buckeye Check Cashing, Inc. ("Buckeye"), contends that *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395 (1967), should be extended to such claims. However, *Prima Paint*'s holding, commonly called the "separability doctrine," is founded upon a statutory default rule of assumed implied consent to arbitration. Amicus Curiae, Samuel Glazer, suggests that when a party opposing arbitration claims that no underlying contract ever came into existence based on state common law principles, or because the contract is void under a statute, *Prima Paint*'s rationale

of implied consent should not be controlling. A claim that no underlying contract came into existence directly implicates the arbitration clause because without the contract, no enforceable provision can arise from it, including an arbitration provision (no contract, no power). Application of *Prima Paint* also would result in an unacceptable circularity of logic – if an arbitrator rules no contract came into existence, then the arbitrator never had authority to issue his decision in the first instance. Arbitrators, who are paid for their time, are also placed in a position of conflicting interests when asked to resolve their own authority. Parties most likely do not anticipate such issues, and a court should not assume that they did so by assuming consent to arbitration.

For these reasons, the Court's decision in *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995), should control all claims that no underlying contract came into existence. The *First Options* Court recognized that parties do not expect such fundamental questions of arbitrability to be decided by the arbitrator, and that the FAA does not allow arbitral resolution of "arbitrability" issues absent clear and unmistakable evidence of the parties' actual consent to send such issues to an arbitrator. A broad, general arbitration provision is not sufficient to establish such actual consent. Buckeye and its supporting amici curiae portend a downfall of the national policy favoring quick arbitral resolution of claims if the Court does not extend *Prima Paint*. But, this Court cautioned in *First Options*: "[T]he basic objective in this area is not to resolve disputes in the quickest manner possible, no matter what the parties' wishes, but to ensure that commercial arbitration agreements, like other contracts, are enforced according to their terms." 514 U.S. at 947 (quotations and citations omitted).

ARGUMENT

The dispositive question of law in this case is: "Under the Federal Arbitration Act, who decides arbitrability when a party claims that the underlying contract containing the arbitration clause never came into existence?" The answer to this question necessitates resolving the palpable tension between this Court's 1967 decision in *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395 (1967), and the 1995 decision *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995). On the one hand, *Prima Paint*'s "separability doctrine" mandates that courts presume that parties implicitly agreed to arbitrate by virtue of the mere superficial appearance of an underlying contract. 388 U.S. at 402-04. On the other hand, under *First Options*, the Supreme Court held that courts, and not arbitrators, must decide arguments going to the basis of an arbitrator's authority unless the parties clearly and unmistakably granted the arbitrator authority to determine his or her own jurisdiction. 514 U.S. at 943-45.

It has been more than a generation since *Prima Paint*. Hostility to arbitration has long since waned, and no one can argue the ability of arbitrators to resolve complex issues of law and fact. Indeed, the arbitral forum and arbitrator are certainly capable of resolving the *merits* of the challenging contractual and statutory questions posed in Glazer's and Buckeye's cases. Capability is not the issue. The propriety of an arbitrator determining his or her own "power" under a doctrine of implied consent is the issue, and any such doctrine should be rejected. *First Options*' requirement of clear and unmistakable evidence of actual consent before an arbitrator can determine his or her own authority represents a more moderated approach

that adequately promotes and protects the voluntary nature of arbitration.

I. *PRIMA PAINT*'S "SEPARABILITY" RATIONALE IS BASED ON A STATUTORY DEFAULT RULE OF IMPLIED CONSENT THAT SHOULD NOT BE EXTENDED TO CLAIMS THAT AN UNDERLYING CONTRACT CONTAINING AN ARBITRATION PROVISION NEVER EXISTED.

A. The *Prima Paint* Decision

With the passage of the Federal Arbitration Act, Congress made arbitration agreements as enforceable as any other contract. The statute explicitly subjects arbitration agreements to the same defenses that can be asserted against any contract: such agreements are valid "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. This Court has unequivocally held that under the FAA, the question of whether the parties entered into an arbitration agreement must be determined under *state law* of contract formation. *See, e.g., First Options*, 514 U.S. at 944; *Allied-Bruce Terminex Cos. v. Dobson*, 513 U.S. 265, 281 (1995). The FAA specifically charges courts, and not arbitrators, with the task of determining this threshold question of whether an arbitration agreement was ever formed. Before requiring arbitration, a court must be "satisfied that the making of the agreement for arbitration . . . is not in issue." 9 U.S.C. § 4.

Thirty-eight years ago in *Prima Paint*, the Supreme Court first addressed the question under the FAA of whether an arbitrator or a court should decide a state law defense addressing the entire underlying contract. *Prima*

Paint involved a claim that a party had been fraudulently induced into entering a business acquisition agreement, which contained an arbitration provision. 388 U.S. at 396-400. The Court narrowly phrased "the central issue" in *Prima Paint* as: "whether a claim of fraud in the inducement of the entire contract is to be resolved by the federal court, or whether the matter is to be referred to the arbitrators." 388 U.S. at 402. Based on Section 4 of the FAA, the *Prima Paint* Court held that a claim of fraudulent inducement "of the arbitration clause itself . . . goes to the 'making' of the agreement to arbitrate" and therefore must be decided by a court. *Id.* at 403-04. In contrast, a claim of fraudulent inducement targeting the underlying container contract does not implicate the making of the arbitration agreement and should therefore be resolved by an arbitrator. *Id.*

This division of authority -- which commonly came to be known as the "separability doctrine" – effectively created a statutory default rule of implied consent. Unless parties agree otherwise, *Prima Paint* interpreted the statutory scheme of the FAA to require a court to assume that parties intend fraudulent inducement claims targeting the underlying contract to be resolved by the arbitrator. The *Prima Paint* Court expressed no opinion as to who decides arbitrability relative to any claim other than that of fraudulent inducement.

B. Courts' Broad Extension of *Prima Paint*

The Court in *Prima Paint* addressed only claims of fraudulent inducement, and courts have since grappled with how far to extend the decision. Many courts have extended *Prima Paint*'s holding in order to compel arbitration of

virtually all claims that the underlying contract never came into existence. These courts automatically refuse to consider such claims, and they do so based on *Prima Paint*'s default rule of implied consent. The only exceptions to the implied consent rule recognized by these courts are the narrowest types of "assent" claims, such as claims that the signature on the underlying contract was forged or that the signing party lacked signatory authority.

Glazer's case is a great example. In Glazer's case below, *Fazio, et al. v. Lehman Brothers, Inc., et al.*, 340 F.3d 386 (2003), Glazer claimed that the underlying contract never came into existence under ordinary principles of state law. The District Court addressed this claim and ruled in favor of Glazer. The Sixth Circuit refused to consider any law or fact regarding this claim. The court applied *Prima Paint*, *Burden v. Check Into Cash*, 267 F.3d 483 (6th Cir. 2001), *cert. denied*, 535 U.S. 970 (2002), and *CBS Employees Federal Credit Union v. Donaldson, Lufkin & Jenrette Secs. Corp.*, 912 F.3d 1564, 1566 (6th Cir. 1990), in what amounted to a perfunctory application of the "separability doctrine." The court summarized the rule that "when claims involve the validity of the contract as a whole and not just the arbitration agreement, such claims are to be brought before the arbitrator. . . ." 340 F.3d at 395 (quotations omitted). The court remanded only issues of forgery and signatory power issues addressing the underlying contract. *Id.* at 397 (citing *Burden*, 267 F.3d at 488-90 (holding that the district court erred in determining allegations of voidness under usury and

lender licensing laws because they did not involve assent)).[4]

Buckeye would have this Court endorse this broad application of *Prima Paint* by sending all claims that the underlying contract is void under state law to arbitration, subject only to "two qualifications." (Pet. Brief at 16.) First, Buckeye concedes that "a challenge directed at the underlying contract goes to the court if it implicates the parties' assent [*in factum*], because a party that did not assent to the underlying contract by definition did not assent to an embedded arbitration clause." (*Id.*) Glazer agrees with this result. Second, Buckeye acknowledges that the parties can "clearly and unmistakably" agree that "a challenge directed at the arbitration clause" itself can be submitted to arbitration. (*Id.*) Buckeye's second qualification references this Court's holding in *First Options of Chicago, Inc. v. Kaplan*, but it fails to acknowledge that the fundamental holding of that case was much broader. *First Options* generally established a requirement that parties must clearly and unmistakably consent to having an arbitrator resolve a claim regarding the basis of the arbitrator's authority. 514 U.S. at 944-45. *First Options* provides the precise framework for resolving claims that the underlying contract never came into existence, as explained in Section II of this brief.

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[4] *See also Jenkins v. First Am. Cash Advance*, 400 F.3d 868, 882 n.12 (11th Cir. 2005) (following *Burden* under similar facts); *Snowden v. Checkpoint Check Cashing*, 290 F.3d 631, 637 (4th Cir.), *cert. denied*, 537 U.S. 1087 (2002) (following *Burden* under similar facts); *Will Drill Res., Inc. v. Samson Res. Co.*, 352 F.3d 211, 215 n.15 (5th Cir. 2001) (rejecting the void-voidable distinction but reserving for the court allegations that the underlying contract was not signed by all necessary parties).

Buckeye and these courts cannot deny the conceptual horror of a court enforcing an arbitration provision in a contract only to have an arbitrator determine that the party's signature to the underlying contract truly was forged. However, by creating exceptions only for claims regarding assent, they ignore a simple reality: *All* claims that an underlying contract *never existed* under state law – for any reason – necessarily place at issue the making of every provision in the contract, including the arbitration provision. Put succinctly, "No contract, no power." *Sphere Drake Ins. Ltd. v. All Am. Ins. Co.*, 256 F.3d 587, 591 (7th Cir. 2001).

For this reason, *Prima Paint* should only apply (if at all) where a party impliedly acknowledges by the nature of its claim that the underlying contract came into existence by seeking to rescind it.[5] The elementary distinction between void and voidable contracts under state law has been recognized by many courts that properly limit *Prima Paint* to claims that an underlying contract is voidable. The leading case is *Sandvik AB v. Advent International Corp.*, 220 F.3d 99, 107-09 (3d Cir. 2000), in which the Third Circuit aptly explained the reasoning behind treating void and voidable claims distinctly:

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[5] A void or void *ab initio* contract "produces no legal obligation." Because it "does not come into existence . . . it cannot be a contract" at all. In contrast, a voidable contract "is an agreement that unless rescinded . . . imposes on parties the same obligations as if it were not voidable." *Sphere Drake Ins. Ltd. v. Clarendon Nat'l Ins. Co.*, 263 F.3d 26, 32 (2d Cir. 2001) (quotations omitted); *see also, e.g., Langley v. FDIC*, 484 U.S. 86, 93-94 (1987) (explaining the different legal effects of void and voidable contracts, citing the Uniform Commercial Code, the Restatement (Second) of Contracts, and Farnsworth's treatise).

> Allowing the District Court to pass on the question whether the arbitration agreement is valid . . . comports with contract law principles. . . . [A]rbitration is a matter of contract, and no arbitration may be compelled in the absence of an agreement to arbitrate. . . . Therefore, there does not appear to be any independent source of validity of the arbitration clause once the underlying contract is taken off the table.

Id. at 107-08; *see also, e.g., Sphere Drake Ins. Ltd. v. Clarendon Nat'l Ins. Co.*, 263 F.3d 26, 30-32 (2d Cir. 2001) (explaining the void-voidable distinction). A party alleging that the underlying contract is voidable, does not, by definition, allege that the underlying contract never came into existence. Because *Prima Paint* did not present a situation in which the arbitrator was asked to determine the very basis for his or her own authority, the claims of fraudulent inducement were properly sent to arbitration.

If no underlying contract was ever formed, no enforceable provision can arise out of it, including an arbitration provision. Buckeye and the courts that apply *Prima Paint* broadly and improperly elevate arbitration provisions to a special legal status, impervious to state law, when they extend *Prima Paint*'s default rule of implied consent even to questions regarding the existence of the underlying contract. This Court's decision in *First Options of Chicago, Inc. v. Kaplan*, which requires clear and unmistakable evidence of actual consent to arbitrate arbitrability, establishes the proper framework for resolving claims that implicate the very basis of the arbitrator's authority.

II. *FIRST OPTIONS* REQUIRES THAT COURTS RESOLVE A CLAIM THAT NO UNDERLYING CONTRACT EXISTS, UNLESS THE PARTIES CLEARLY AND UNMISTAKABLY EVIDENCE THEIR ACTUAL CONSENT TO SEND SUCH A CLAIM TO ARBITRATION.

Conspicuously absent from the briefs of Buckeye, and amici curiae in support of Buckeye, is a proper recognition of *First Options*. In *First Options of Chicago, Inc. v. Kaplan*, this Court addressed whether an arbitrator could determine the basis for his or her own authority when a party claimed that it never entered into the underlying contract. This Court refused to recognize implied consent to arbitrate this arbitrability question, holding that "[c]ourts should not assume that the parties agreed to arbitrate arbitrability unless there is clear and unmistakable evidence that they agreed to do so." 514 U.S. at 944 (quotations omitted).

In *First Options*, a stock trading firm (First Options) sought to arbitrate its claims for payment under a debt work-out agreement against Manuel Kaplan, Carol Kaplan, and Manuel Kaplans' investment company. 514 U.S. at 940. Although the investment company signed a document containing an arbitration agreement, the Kaplans themselves did not sign the document, and they contended that First Options' claims against them were therefore not arbitrable. *Id.* at 941. The arbitrators decided that they had jurisdiction to rule on the merits of all the disputes, and they rendered a decision in favor of First Options. *Id.*

The Kaplans asked this Court to review the question of whether the court or the arbitrator should have the primary power to decide "whether they agreed to arbitrate the merits." *Id.* at 942. The Court divided this question

into three levels of sub-questions: (1) the "merits" question – whether the Kaplans were liable to First Options under the work-out contract; (2) the "arbitrability" question – whether the Kaplans decided to arbitrate the merits; and (3) "who should have the primary power to decide" the second-level question. *Id.*

In analyzing the Kaplans' third-level question, the Court explicitly reversed any pro-arbitration presumption when arbitrators are asked to determine the existence of their own authority:

> Courts should not assume that the parties agreed to arbitrate arbitrability unless there is "clear and unmistakable" evidence that they did so. In this manner the law treats silence or ambiguity about the question "*who* (primarily) should decide arbitrability" differently from the way it treats silence or ambiguity about the question "*whether* a particular merits-related dispute is arbitrable because it is within the scope of a valid arbitration agreement" – for in respect to this latter question the law reverses the presumption.

Id. at 944-45 (citations omitted). Therefore, under *First Options*, clear and unmistakable evidence of actual consent is necessary before a claim concerning arbitrability can be sent to arbitration.

Sending to arbitration a claim that the underlying contract never came into existence also improperly empowers an arbitrator to decide the basis of his or her own power. A uniquely circular issue arises – if the contract never existed, then the arbitrator never had any authority in the first place. In addition to this logic conundrum, it cannot seriously be denied that an arbitrator has a clear

financial interest in finding and retaining jurisdiction. Even if he does not act on that interest, the appearance of a potential conflict of interest remains.[6] The circularity of logic and potential conflict of interest merit strongly against *Prima Paint*'s default implied consent model, and heavily in favor of the *First Options*' requirement of actual consent to arbitrator resolution of "third-level" arbitrability questions via clear and unmistakable evidence. This requirement best maintains court and arbitral integrity, and avoids potential constitutional concerns. *Cf. Commonwealth Coatings Corp. v. Cont'l Cas. Co.*, 393 U.S. 145 (1968) (holding that an arbitrator's regular service as an engineering consultant for a party was grounds to vacate the arbitrator's decision, even without reason to suspect that the arbitrator acted out of bias); *see also Prima Paint*, 388 U.S. at 416 (Black, J., dissenting) ("I think it raises serious issues of due process to submit to an arbitrator an issue which will determine his compensation."); *Connally v. Georgia*, 429 U.S. 245 (1977) (holding that the issuance of a search warrant by a justice of the peace who was compensated based on the number of search warrants issued violated due process); *Gibson v. Berryhill*, 411 U.S. 564 (1973) (finding bias where a state agency regulating optometry was composed of independent optometrists who had an interest in revoking the licenses of optometrists employed by large businesses).

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[6] Tellingly, over the Kaplans' objections, the arbitrators in *First Options* chose to retain jurisdiction when faced with the question of whether the parties had agreed to arbitrate in the first place. 514 U.S. at 941. This is *not* to suggest that all arbitrators will necessarily act out of self-interest, but even the appearance of such potential impropriety counsels in favor of requiring clear and unmistakable consent to arbitrate.

As a policy matter, this Court has recognized that when a party claims it never agreed to arbitrate in the first place, consent to arbitration of this claim cannot be assumed from that party's "silence or ambiguity" because "doing so might too often force unwilling parties to arbitrate a matter they reasonably would have thought a judge, not an arbitrator, would decide." *First Options*, 514 U.S. at 945. Express consent is necessary because "[a] party often might not focus upon that question or upon the significance of having arbitrators decide the scope of their own powers." *Id.* at 945.

Buckeye, and amici curiae supporting Buckeye, contend that any rejection of their position on *Prima Paint* "separability" will cause undue delays and will thus undermine a national policy favoring arbitration as a quick resolution of disputes. Not only are such concerns without basis, but this Court cautioned in *First Options* that "the basic objective in this area is not to resolve disputes in the quickest manner possible, no matter what the parties' wishes, but to ensure that commercial arbitration agreements, like other contracts, are enforced according to their terms." *Id.* at 947 (quotations and citations omitted). The FAA and this Courts' rulings should not be used as mere conveniences to clear court dockets.

A requirement of express consent also comports with the clear legislative history of the FAA and parties' constitutional rights. By applying *Prima Paint*'s default rule of implied consent even when it is alleged that the underlying contract never existed, Buckeye, and the courts that broadly apply *Prima Paint*, improperly elevate arbitration provisions above state law. This result contravenes the very purpose of the FAA as declared by Congress, which was "simply to make the contracting party live up to his

agreement" by placing an arbitration agreement "upon the same footing as other contracts, where it belongs." H.R. Rep. No. 96, at 1 (1924); *see also* Julius Henry Cohen & Kenneth Dayton, *The New Federal Arbitration Law*, 12 Va. L. Rev. 265, 279 (1926) ("No one is required to make an agreement to arbitrate. Such action by a party is entirely voluntary. When the agreement to arbitrate *is* made, it is not left outside of the law.... It is merely a new method for enforcing a contract freely made by the parties thereto.").

The American Bar Association's proponent of the FAA explained:

> A Federal statute providing for the enforcement of arbitration agreements does relate solely to the procedure of the Federal courts. It is no infringement upon the right of each State to decide for itself what contracts shall or shall not exist under its laws. To be sure whether or not a contract exists is a question of the substantive law of the jurisdiction wherein the contract was made.

Arbitration of Interstate Commercial Disputes: Joint Hearings on S. 1005 and H.R. 646 Before the Subcomms. of the Comms. on the Judiciary, 68th Cong. 37 (1924) [hereinafter *Joint Hearings*] (brief submitted by Julius Henry Cohen).

Indeed, this Court has consistently reaffirmed adherence to the state law of contract formation:

> In any event, § 2 gives States a method for protecting consumers against unfair pressure to agree to a contract with an unwanted arbitration provision. States may regulate contracts, including arbitration clauses, under general contract law principles and they may invalidate an arbitration clause "upon such grounds as exist at law

> or in equity for the revocation of any contract." 9 U.S.C. § 2 (emphasis added). What States may not do is decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause. The Act makes any such state policy unlawful, for that kind of policy would place arbitration clauses on an unequal "footing," directly contrary to the Act's language and Congress' intent.

Allied-Bruce Terminex Cos. v. Dobson, 513 U.S. 265, 281 (1995). Buckeye and many courts would ignore states' rights to determine which contracts exist and which do not.

Not only is the result urged by Buckeye untenable under the FAA, but it contravenes the Constitution. Congress recognized the need to preserve these rights:

> *The one constitutional provision we have got is that you have a right of trial by jury.* But you can waive that. And you can do that in advance. Ah, but the question whether you waive it or not depends on whether that is your signature to the paper, or whether you authorized that signature, *or whether the paper is a valid paper or not*, whether it was delivered properly. So there is a question there that you have *not waived* the right of trial by jury on.

Joint Hearings at 15-17 (statement of Julius Henry Cohen addressing concerns about "take-it-or-leave-it" contracts) (emphasis added).

Depriving a party of its right to have a court determine the making of the arbitration agreement violates that party's rights to a judicial forum under Article III, a

jury trial under the Seventh Amendment, and due process under the Fifth and Fourteenth Amendments. *See, e.g.*, *Prima Paint*, 388 U.S. at 407 (Black, J., dissenting, Stewart, J., Douglas, J., joining) (stating that "forcing a person to forgo his opportunity to try his legal issues in the courts where, unlike the situation in arbitration, he may have a jury trial and right to appeal" may be a "denial of due process"); *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989) (holding that Congressional action requiring that bankruptcy-related claims be resolved in a non-Article III forum without the use of a jury may violate parties' Article III and Seventh Amendment rights). Requiring clear and unmistakable, actual consent before an arbitrator is permitted to decide the existence of the underlying contract containing the arbitration provision best preserves the parties' rights.

CONCLUSION

To quote Judge Frank Easterbrook, *Prima Paint* "sits uneasily aside" *First Options. Sphere Drake Ins. Ltd. v. All Am. Ins. Co.*, 256 F.3d 587, 590 (7th Cir. 2001). For the reasons stated in this brief, overturning *Prima Paint* should be considered by this Court, if not in the current case then in another appropriate case. At a minimum, the holding of *Prima Paint* should not be extended to claims that the underlying contract containing the arbitration provision never came into existence. Such claims directly implicate the arbitrator's authority and result in an unacceptable circularity of logic that, frankly, most ordinary people signing contracts throughout our economy and across industries will find both surprising and wholly unacceptable. Indeed, the integrity of the courts and arbitration is at

stake. Buckeye and amici curiae in support of Buckeye trumpet a parade of "horribles" if *Prima Paint*'s "separability doctrine" is not extended to require arbitration of claims that no underlying contract exists. They too easily ignore this Court's cautionary warning: "[T]he basic objective in this area is not to resolve disputes in the quickest manner possible, no matter what the parties' wishes, but to ensure that commercial arbitration agreements, like other contracts, are enforced according to their terms." *First Options*, 514 U.S. at 947 (quotations and citations omitted). *Prima Paint* should at least be limited to its discrete facts involving a claim that the underlying contract was voidable, and not that it was void or never existed in the first place. *First Options* and its "clear and unmistakable" standard of actual consent to arbitration should be applied to all claims that the underlying contract never came into existence. This framework best protects parties' rights under the FAA, Congress' intent, the voluntary contractual nature of arbitration, parties' expectations, and the parties' Constitutional rights.

Respectfully submitted,

KENNETH D. SCHWARTZ, *Counsel of Record*
ROBERT P. DUVIN
EMILY C. FIFTAL

DUVIN, CAHN & HUTTON
Erieview Tower, 20th Floor
1301 East Ninth Street
Cleveland, Ohio 44114
Telephone: (216) 696-7600
Facsimile: (216) 696-2038
kschwartz@duvin.com
rduvin@duvin.com
efiftal@duvin.com

Counsel for Amicus Curiae